# PPI Supporting Member's Event: Freedom and Choice in Pensions

On 12 May 2014 the PPI held a Supporting Member's event to discuss HM Treasury's Budget consultation paper on Freedom and Choice in Pensions, which seeks views on changes to the taxation of DC pension savings and how they are accessed in retirement.

The event was attended by over 65 people representing a broad range of interests within Government and the pensions industry and exclusively comprised PPI Supporting Members and organisations who have commissioned research or otherwise supported the PPI during the last 12 months.

**Chris Curry, PPI Director,** introduced and chaired the seminar.

**David Gauke MP, Exchequer Secretary to the Treasury,** provided an overview of the Budget consultation paper and discussed the Government's vision for the future for savers and the retirement income market; the guarantee of face-to-face guidance at retirement; and Government expectations from industry.

Several minutes were allowed for discussion and questions from the floor. The following points were raised:

- The question was asked that, if the new flexibilities mean that annuities are to be no longer the default option for accessing DC savings, what will the new default be?
- There was a fair amount of concern regarding the guidance guarantee and whether people would be sufficiently enabled to engage with the guidance. There was a question around whether the guidance would be limited to retirement issues or would include discussion of other themes that the Government was keen to communicate with people about (such as health issues and long-term care needs). There was concern regarding how best to protect people from poor quality or partial guidance.
- There was discussion regarding the potentially conflicting philosophies behind auto-enrolment (which relies on inertia and the "nudge" principle) and the new tax regime (which is based on a philosophy of freedom, flexibility and personal responsibility). There was concern regarding whether these two philosophies could simultaneously be

applied to pension savings without creating confusion and difficulties for consumers.

**Patrick Heath-Lay, Chief Executive of B&CE, provider of The People's Pension,** shared the provider perspective on the Budget proposals and the potential implications for the DC market and automatic enrolment. He urged the industry to "get it right" through production of high-quality products which would help people to navigate the new flexibilities. He expressed concern that the current regulatory system was too heavy on industry and may stifle innovation.

**Mel Duffield, Deputy Director of the PPI,** presented new PPI research on how people access DC savings in other countries, and outlined the implications that international experience has for how the retirement income landscape may change after the new flexibilities are introduced, and the potential futures sources of demand for annuities.

**Panel Session 1:** "The implications for pre- and post-retirement product design and innovation" This session was chaired by **Chris Curry, Director of the PPI**

Panel members:

**Nigel Barlow, Director of Product Development, Partnership**
**Maddi Forrester, Head of UK Institutional, AXA Investment Managers**
**Hugh Nolan, Chief Actuary, JLT Employee Benefits**
**Darren Philp, Head of Policy, The People's Pension**

**Darren Philp,** gave an overview of his reaction to the 2014 Budget. He mentioned that, prior to the announcement, he had drawn attention to the fact that people were making decisions about how and when to access their DC pension savings in order to get hold of their tax-free lump sums, and that these decisions may not have been appropriate to their circumstances. He remarked that pension providers and the broader pensions industry are keen to improve the pensions landscape so that it meets individuals' needs. He highlighted the need for default funds to be fit for purpose in the new landscape and outlined how the Budget announcement marks an opportunity for some innovative and imaginative thinking by the industry.

**Hugh Nolan**, emphasised that it may no longer be relevant to refer to income in retirement as pensions – it may be better described as the process by which individuals withdraw cash from their funds. He highlighted the importance of having an effective investment strategy both before and after retirement. He also drew attention to particular challenges; including the negative portrayal of annuities by the press; people's tendency to underestimate their life expectancy; and the unpredictability of the random variation of life expectancy for individuals. He described contrasting attitudes around whether financial advisors offer value for money – there was no clear consensus, for example, about whether a financial advisor who charged a fee of 5% of the fund value but found an open market option that was worth 30% more in rates should be considered to have provided advice which was good or bad value.

**Maddi Forrester** put forward the view that the proposals do not represent a major departure from existing social trends towards greater flexibility around retirement. She reflected that the pensions and investment industry were already working towards the provision of more flexible drawdown products and that they will now be working on this with more urgency. She pointed out that the problems in this area are depressingly familiar: there is a lack of financial education around pensions and it is difficult for people to understand the risks they are facing. She was concerned that a general lack of trust in the pensions industry could mean that many people will be concerned that organisations are trying to make money from them rather than offering them products that are best suited to their needs, and that this could impede effective engagement from savers.

**Nigel Barlow** indicated that while people express a dislike of annuities, in practice they gravitate towards a guaranteed income. There is a challenge for the industry around meeting individuals' changing needs as they go through their retirement and may need access to cash sums in differing amounts, particularly if they need social care (although, he pointed out, most people do not currently believe they will need social care). He was concerned that many people did not understand how annuities work, pointing out that 60% of people who've purchased annuities are unaware that they have done so. He emphasised that in order for the new system to work effectively people must be given more choices, alongside high quality advice and guidance. Nigel also predicted that many people will still wish to purchase an annuity in the future, albeit at older ages.

**Discussion**

The following points were raised:

- There was discussion around the fact that, in the past, some individuals had bought products that did not meet their needs. There was also some discussion around the trend towards more flexible working lives, with increasing numbers of individuals over SPA now working part-time. It was emphasised that providers will have to work harder and innovate more in the future to meet these changing needs.

- There was discussion around whether accessing retirement income should be described as decumulating or drawing down income. One view was that it should be described as accumulation, transition and decumulation while another was that it should be seen as joining up of accumulation and decumulation.
- There were some questions around how funds' investment strategies might change in future. There was discussion around the need for each fund to have a default investment strategy and the importance of knowing each employee's requirements.
- The importance of engaging people was discussed. Challenges to engagement include the difficulty individuals face in locating and considering information around their pensions. Linked to this was the importance of ensuring that any information provided under the Guidance Guarantee is easy to understand.
- It was felt that past experience had taught the industry that now it will be essential to: pare back complexity; provide a period of stability to enable changes to bed in; and, allow the pensions industry an opportunity to rebuild consumers' trust.

**Panel Session 2:** "Providing support and guidance for members post April-2015." This session was chaired by **Alan Woods, independent consultant and PPI Governor.**

Panel members:

**Michelle Cracknell, Chief Executive, The Pensions Advisory Service**
**Alan Higham, Head of Retirement Insight, Fidelity**
**Kerstin Parker, Senior Policy Adviser, HM Treasury**
**Alex Roy, Manager, Life and Pensions, Financial Conduct Authority**

**Michelle Cracknell** discussed the high volume of calls that TPAS had received since the Treasury's announcement, showing renewed interest in pensions due to the new freedom of choice. Though she noted that people did not seem to understand how much tax they would need to pay on money they had withdrawn. She highlighted concerns that too much choice would result in people defaulting into doing nothing e.g., taking all their savings as a lump sum, depositing it into a bank account and then leaving it there.

**Alan Higham** believed that the new flexibilities created great opportunities for industry and that new products could now be developed which would increasepeople's income in retirement. However, he was also concerned that consumers did not understand the implications of the new freedoms, particularly their implications for the tax position of pension savings and income. He reported that some people had already responded to the announcement by "spending" all their savings (e.g., through booking a holiday) before taking it out, in some cases only then discovering they were below the age of access, or could access their 25% tax-free lump sum but only if they purchased a retirement income product. He reported that some of these people were being defaulted into purchasing an annuity from their provider without taking any time to explore whether it was the best product for them.

The following points were raised:

- In Australia, where people are allowed unlimited access to lump sums after retirement age, a phenomenon has developed whereby people are accruing debt with the intention of paying it off with their pension savings when they reach retirement age and thereby potentially jeopardising their income in retirement.
- Concerns were raised about whether the guidance programme will be sufficient to support people through long and complex retirements which will include changes in both needs and circumstances. It was pointed out that the guidance would need to be extensive to cover the range of different products, circumstances and decisions an individual with DC savings may be faced with at the point of retirement and after.
- It was felt that the guidance would need also to fit within a broader "conversation" with industry and providers about how they were adapting to meet the new needs of consumers under the new flexibilities.
- It was queried whether £20m would be sufficient to generate a guidance programme that could support savers not only at the first point of accessing their DC pension savings but right through retirement.
- There was concern that investment in a sophisticated IT system may be required in order to ensure that the data of those seeking guidance could be stored for follow-up sessions during later retirement.
- There was general agreement that there was no clear picture of what a "good" outcome for consumers actually looked like.
- There was discussion regarding how to measure the quality of guidance and its outcomes. It was recognised that there would be difficulties in measurement because there may not be data on what decisions people made after receiving guidance.
- Several people felt that face-to-face guidance would be favoured by many consumers and there was concern that this would be the most expensive way to for providers to deliver guidance.

- There was some discussion regarding the role of the regulator. It was unclear who would be providing the guidance e.g., schemes, employers, advisory bodies. There was not yet a clear picture how the guidance would be regulated and how quality would be monitored.

**Panel Session 3:** "The Changing Retirement Landscape." This session was chaired by **Alan Woods, independent consultant and PPI Governor.**

Panel members:
**Helen Forrest, Head of Policy and Advocacy at NAPF;**
**David Hutchins, Chair of IMA's DC Committee;**
**Barry O'Dwyer, Member of ABI's Long Term Savings and Life Insurance Committee**

**Helen Forrest** spoke from the perspective of providers of occupational pension schemes. She said it is becoming harder to deliver a tailored service to scheme members who now experience a lot more variation in how they decumulate pension assets than previous generations did. She also pointed out that it was harder to anticipate member needs as many scheme members do not make decisions as to how they want to take their pension fund until they're close to retirement.

She commented that there is a lack of understanding of how the changes announced in Budget 2014 would work in practice within schemes, for example how using schemes into retirement as drawdown vehicles might work.

She suggested that with all the changes occurring within pensions, an appropriate guidance scheme is critical. She was concerned that there is a risk of more engaged employers who currently offer good guidance stepping back from what they currently offer and levelling down to the new standard introduced by the Budget changes.

**David Hutchins** noted that there has been a reversal in the approach to choice in respect of pre and post retirement choices. Under the old system joining a pension scheme was voluntary, but the way in which the pension fund was used at retirement was compulsory. Under auto enrolment and the reforms announced in the Budget, choice and compulsion have switched: being a member of a pension scheme is no longer an active choice, but the saver faces a choice as to how to use their fund at retirement.

He said that choice itself should be optional, and that there should be defaults in place for those who do not wish to make a choice.

He suggested that the expectation of advice being required at a single point in retirement is wrong. Pension savings and their use in retirement are a whole life journey. Decisions need to be made throughout both the savings phase and during retirement.

He believed that it would be essential for the stability of the pension saving system going forward that tax-relief on savings does not change. He pointed out that any changes would be especially damaging to public sector pension scheme members whose pensions have just been though a complete overhaul.

**Barry O'Dwyer s**aid that the traditional view of two phases, of accumulation and decumulation, no longer applies. He pointed out that, therefore, guidance is required over a longer period, not just once at the point of retirement. He believed that this would complicate matters for employers trustees and providers who were trying to deliver guidance.

He pointed out that the traditional view of tax relief was that relief on contributions and tax on the income during retirement acted to smooth tax over a person's lifetime. He suggested that if the pension savings do not have to be taken as a stream of income in retirement following the Budget announcements, then the traditional view of smoothing over a lifetime's income no longer holds.

He felt that annuities would still have a role to play for those who would need security and protection, but speculated that the average age of annuity purchase may raise to somewhere around age 70 or above.

The following points were raised:

- There was discussion around the possibility that savers may use new freedoms to seek to increase their returns. It was considered that, while people may like choice and flexibility in how they use their funds, that does not mean they like risky investments; strategies that promise to double your money may be less attractive to people when the risks are fully explained.
- It was noted that certainty of income is important to people and that annuities will likely still be sold to people who value certainty.
- There was some discussion around people's lack of understanding of retirement income products and how this lack of understanding may affect their decisions at retirement. It was suggested that, of the options available at retirement, taking cash was the easiest to understand (while

annuities and drawdown were complex and confusing) and may therefore be the most attractive option for many people, even if it isn't the most suitable option for everyone.

- It was noted that it is more likely to for consumers to achieve "good" outcomes in retirement if guidance or advice services engage with them at several points over a period of time rather than just once.
- There was discussion around how to encourage or trigger people to make a decision about what to do with their pension fund, noting that it is a natural human tendency to put off decisions about pensions for as long as possible and that cognitive ability declines with age. It was suggested that one potential trigger could be the potential interaction of pension saving/capital held and long-term care needs.